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BACKGROUND INFORMATION

EXCISE

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NON-PROLIFERATION

Energy Secretary O'Leary's February visit piqued Chinese interest in implementing the 1985 Agreement on Peaceful Nuclear Cooperation. Expert level meetings occurred in conjunction with VFM Liu's visit.

In her meeting with VFM Liu, Under Secretary Davis sought to follow up on the nuclear cooperation issue, to continue dialogue with China on issues of immediate concern such as the NPT, and to re-open and advance our dialogue on missile proliferation, export controls, and regional issues such as South Asia and Northeast Asia. Ultimately, we seek to regularize consultations with China on these issues in order to increase China's contribution to resolving non-proliferation issues before they become bilateral irritants.

SOUTH ASIA NON-PROLIFERATION

Both India and Pakistan are capable of building a limited number of nuclear weapons within a short period of time. Both are developing ballistic missiles capable of delivering weapons of mass destruction and face domestic political pressures that make unilateral steps towards disarmament politically dangerous.

DEPARTMENT OF STATE		IS/PPG/CDR	PFG	Date: 12/5/96
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SPRATLYS

The Spratly Islands and parts of the South China Sea are subject to conflicting territorial claims among China, Vietnam, Taiwan, the Philippines, Malaysia and Brunei. There have been occasional incidents involving the different claimants to the SCS. Past incidents have usually involved China and Vietnam, which, in 1988, fought skirmishes over the Spratlys which resulted in loss of life. The most significant recent series of actions (and reactions) have involved China and the Philippines.

In February 1995, the GOP discovered that China had constructed new outposts in a disputed area of the Spratlys (Mischief Reef). In response in March, the GOP navy destroyed a number of Chinese markers on reefs within the disputed area and seized five Chinese fishing vessels in the claimed GOP EEZ.

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Also, in March, a Malaysian vessel fired warning shots at a Chinese fishing trawler operating in the Malaysian EEZ in the South China Sea. Four Chinese fishermen were injured. Taiwan reversed its decision to send police boats to the Spratlys.

In a demarche to Beijing in February, the U.S. expressed concern over the Chinese occupation of Mischief Reef noting that it would encourage a pattern of action and reaction by other claimants. The Chinese said their action did not jeopardize freedom of navigation in the SCS nor did it pose a threat to the peaceful resolution of disputes.

While the Chinese activity on Mischief Reef was the first confirmed new construction of outposts by the Chinese since 1988 and the closest yet to Philippine territory, all other claimants (except Brunei) have constructed similar outposts in or near the Spratlys, before and after 1988. Vietnam's 20 outposts are the most numerous; the PRC has seven.

In March 1995, the ASEAN Foreign Ministers issued a statement on the South China Sea, which was unexpectedly direct and specific, expressed concern about recent developments and called upon all parties to refrain from further destabilizing actions. The Vietnamese are on record as supporting the ASEAN statement. Bilateral consultations were held in March between China and the Philippines; no agreements were reached beyond an understanding to continue talks at an unspecified date.

In 1993, China and Vietnam agreed in principle to resolve their territorial disputes peacefully and to begin working level negotiations. To date, the two sides have achieved limited progress on land border and the Tonkin Gulf, but have made no progress on territorial issues in the SCS. Territorial disagreements have been exacerbated by efforts by both sides to grant oil exploration concessions in disputed areas. Two of these -- Vietnam's Blue Dragon and China's Crestone concessions -- involve U.S. firms. In June 1994, the Philippines also granted a U.S. firm an exploration permit in an area China also claimed.

Since 1990, Indonesia--which has no claims on the Spratlys-- has hosted a series of unofficial workshops to create a climate conducive to conflict resolution among the claimants. The U.S. has supported Indonesian efforts to seek a solution to the disputes and has endorsed an ASEAN resolution calling for peaceful resolution of this issue. China has participated in these workshops but has opposed "internationalization" of the disputes. China's position is that its sovereignty over the Spratlys is nonnegotiable and that related territorial issues should be resolved bilaterally. China has called for joint development of South China Sea (SCS) resources while temporarily shelving the territorial disputes.

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HUMAN RIGHTS

The comprehensive engagement strategy approved by the President in September 1993 remains our roadmap to pursue our human rights interests with the Chinese, as well as geopolitical, economic/commercial and other interests. In May 1994, the President announced that we would pursue our human rights objectives in China vigorously through strategies and mechanisms other than MFN.

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Chinese human rights practices have not improved in the past year. Government measures against political and social dissent have become steadily more repressive.

Since mid-1993, we have conducted seven sessions of bilateral human rights dialogue; in the latest round, A/S John Shattuck travelled to Beijing in January to stress our core concerns while expanding the dialogue to foster cooperation on legal reform and legal exchanges.

we joined the EU and Japan in co-sponsoring a China resolution at the UNHRC. For the first time since 1990, a Chinese procedural motion to take "no action" on the resolution was defeated. The resolution itself was defeated, but narrowly (20 (U.S.)-21-12).

Since the UNHRC vote, Chinese officials have stressed the need to handle differences over human rights bilaterally, intimating that further dialogue sessions are possible. Other than one brief detention and release, Chinese authorities have not acted against key dissidents who petitioned the National People's Congress in early March.

COMPREHENSIVE ENGAGEMENT -- HIGH-LEVEL VISITS

In September 1993 the President initiated a policy of comprehensive engagement to pursue our national interests with China. A key element in this intensive, high-level dialogue is to provide strategic reassurance to China and to seek its constructive participation in the international community. It also allows the overall relationship to survive rough patches.

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Over the past several months we made some important progress and the downward spiral that loomed in January failed to eventuate. ✓

Energy Secretary O'Leary's February 15-24 visit set a positive tone; yielded \$6 billion in new contracts; spotlighted the potential for cooperation in sustainable development; and got approval to schedule bilateral experts talks on removing barriers to U.S. sales of nuclear power technology to China.

Our IPR talks had a perils of Pauline quality, but in the end we concluded a last-hour accord on February 28 which averted a trade war and set the stage for a good visit by Ambassador Kantor from March 11-13. Kantor's discussions created a more positive environment for negotiations on WTO accession --

Commerce U/S Gatten is in China April 9-14 to prepare for the next Joint Commission on Commerce and Trade (JCCT) tentatively scheduled for July in Beijing with Secretary Brown co-chairing.

The pace of military-to-military exchanges picked up. Chinese NDU President Zhu visited in late February/early March; the USS Bunker Hill paid a successful port call in Qingdao -- the first to China since May 1989; and LTG Xiong Guangkai, a senior military intelligence official, had a good visit March 27-29, reciprocating ASD Warner's "transparency briefing" on our threat assessment and force posture. These exchanges lay the groundwork for CINCPAC Adm. Macke's visit to China during the final week of April, and for visit here DOD is proposing for June 19-20 by Chinese Defense Minister Chi Haotian.

We also have under consideration a Chinese request for the newly appointed commander of the PLA Air Force to visit the U.S. in May, and a possible visit by General Shalikashvili to visit China in late August or early September.

Thanks to the return to a more positive tone in relations, the Chinese did not condition the holding of non-proliferation talks with U/S Davis and Liu was accompanied by experts to participate in parallel talks on nuclear cooperation. We also asked the Chinese to accept export controls talks in late May.

Another major factor in reorienting the Chinese to a more positive approach to bilateral relations was your February letter to FM Qian. A/S Lord's March 1 discussions in Beijing -- expressly keyed to that letter, and its emphasis on seeking common ground so as to advance bilateral relations -- produced an agreement by Qian to meet with you in New York (on April 17) and to send VFM Liu Huaqiu to "advance" his visit through talks hosted by U/S Tarnoff.

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The Chinese probably interpreted Vice President Gore's agreement to meet with Premier Li Peng in Copenhagen (on March 12) as a welcome signal of U.S. "sincerity" in pursuing more constructive relations. (It was, however, a testy encounter centering on human rights.)

The Chinese may see in that meeting an indication that a Vice Presidential or Presidential visit to China in 1995-96 may not be entirely out of the question. '

WTO ACCESSION, APEC AND BILATERAL TRADE ISSUES

As a major actor in and beneficiary of the world economic system, China must also share in the responsibility for maintaining that system. This is particularly important in Asia where China's size and population magnify its importance. APEC and the World Trade Organization (WTO) are the organizations which embody this responsibility. China is a member of APEC, and is reluctant to make the concessions necessary to join the WTO. China has constantly emphasized that recognition of its developing country status is a prerequisite to discussing how far China can go in liberalizing its economy in line with the general direction of these multilateral organizations' policy recommendations. China is too big and too important to be given blanket developing country status in trade policy. [

In our 1992 bilateral market access agreement, the United States pledged to "staunchly support" China's GATT accession, on the basis of an acceptable protocol package. The purpose of the accession negotiations is to work out the detailed commercial measures that China will need to adopt in order to bring itself into compliance with basic GATT and WTO obligations.

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In a December 1994 round of accession negotiations, a broad coalition of WTO members agreed that China had not made the commercial commitments necessary to complete its accession.

In January 1995, China advised us that it had suspended implementation of our bilateral market access agreement because, China alleged, the United States had not fulfilled its obligation to "staunchly support" China's accession.

During USTR Kantor's March 10-13 trip to Beijing, China agreed to resume implementation of the market access agreement. At the same time, Kantor promised his personal support for China's efforts to negotiate an acceptable WTO accession package.]

At the invitation of the Chairman of the multilateral WTO Working Party, China has tentatively agreed to return to the negotiating table in Geneva in mid-May.

China is behind schedule in implementing a number of previous commitments under our bilateral Market Access MOU.

SUSTAINABLE DEVELOPMENT

There is broad interagency agreement that a sustainable development initiative with China is a good idea, not only because it would create a new and positive element in the relationship, but because it will be popular and easy to sell domestically. It would also promote our commercial interests.

The Vice President is interested and willing to become more involved as the initiative evolves. The Vice President's office is looking for ways to structure his initiative other than the reciprocal visits which are the centerpiece of the Gore-Chernomyrdin, Gore-Mubarak, and Gore-Mbeki initiatives.

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One of the major impediments to broader cooperation in this area remains the Tiananmen sanctions' restrictions on funding for cooperative operations in China. For instance, the entrance of U.S. AID's Asia Environmental Partnership (AEP) into China would allow us to broaden the scope of cooperative efforts. AEP might provide a stronger commercial base for U.S. firms than the more technical EPA programs, which are ongoing.

Because AID does not operate in China, USG cooperation is limited to ongoing USG agency programs. The EPA has been actively involved in environmental research and management with China since the early 1980's. Most of EPA's activities with China occur under an Environmental Cooperation Protocol, signed in 1980. EPA works through the National Environmental Protection Agency in China.

EPA's China Program emphasizes cooperative research that advances both U.S. and PRC domestic environmental protection activities, and cooperation that addresses the most critical environmental concerns such as protection of the stratospheric ozone layer and reduction of greenhouse gas emissions.

The Commerce department is adding an environmental component to the JCCT which is being developed. This might complement EPA activities, or possibly act as a substitute for the U.S. Asia Environmental Partnership (AEP), since AID has no program in China.

BEIJING WOMEN'S CONFERENCE

China is scheduled to host the Fourth World Conference on Women in Beijing, September 4 - 15, 1995. This will undoubtedly be the largest such gathering ever held. The GOC underestimated the number of non-governmental organizations (NGOs) that would wish to attend, including some whose focus is on Taiwan or Tibet. Consequently, the GOC has put pressure on the secretariat of the conference to reject the applications of some of the China-oriented NGOs for accreditation to the conference itself.

China has signed a standard UN host-country agreement, committing itself to respect the criteria established by the General Assembly for accreditation of NGOs. (FYI: these criteria are "relevance and competence".)

In addition, citing "structural problems" in the original site, the GOC has recently announced a decision to move the NGO Forum, a fair-like gathering of accredited and non-accredited NGOs, to a site far removed from the conference itself.

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UN PEACEKEEPING ASSESSMENTS

On March 28, we delivered the Secretary's letter seeking support to reform the UN scale of peacekeeping assessments, including reduction to 25 percent of the U.S. peacekeeping assessment rate. Consistent with past discussions, the PRC was cool to our proposal, declining to offer any support.

The Chinese believe that the primary causes of the UN financial problems are the increase in the UN's operations and late payments by certain member states (e.g., U.S.). Most alternative formulations now on the table (including that of the UK which we have accepted as a starting point) would increase the Chinese peacekeeping assessment rate. We have called for a P5 floor in the peacekeeping scale. This would triple China's rate from 0.897 to 3.0 percent.

In a UN working group, China has stayed quiet behind the cover of G-77 statements opposing any significant change of the PKO scale. Some in G-77 believe China should pay more. As have many countries, China has complained about "unilateral" U.S. action and argued for importance of consensus on the peacekeeping assessment scale.

IRAQ SANCTIONS

UNSCOM Chairman Ekeus will make his next major report to the Security Council April 10. He is expected to express general satisfaction with Iraqi cooperation in all areas, with the important exception of biological weapons. In anticipation of this, the French and Russian delegations are backing off earlier plans to table a draft resolution lifting the oil export embargo.

China supports an early lifting of sanctions, [The Chinese position has less to do with sympathy toward Iraq or commercial interest than it does with China's opposition in principle to economic sanctions. The Chinese will probably not oppose, but also will not actively support, the new Argentine draft resolution that would permit Iraq to sell oil to purchase food and humanitarian items.

The new humanitarian resolution is a revised version of UNSCRs 706/712, which would have permitted Iraq to sell a limited amount of fuel to purchase humanitarian supplies. The new resolution was drafted to address arguments made in the past by the GOI to justify its refusal to implement 706/712. Most importantly, the Iraqi government -- not the UN -- will be responsible for distribution of the items purchased with the oil proceeds (except in the Kurdish areas.) Further, the new resolution increases the amount of oil Iraq can sell. 706/712 would have permitted a one-time sale of \$1.6 billion worth of oil, the new resolution allows Iraq to sell \$1 billion worth every ninety days for as long as it complies with the terms of the resolution.

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LIBYA SANCTIONS

Libya is a state sponsor of terrorism and has been a threat to U.S. national security under Qadhafi. Libya is expanding and safeguarding its CW production capabilities and seeks to acquire ballistic missiles.

Nine successive UNSC reviews have determined that Libya has not complied with the UNSC's demands, including surrender of the PA 103 suspects for trial in the U.S. or UK and ceasing Libyan involvement in terrorism. We see no evidence Qadhafi will comply fully. We continue to work with the international community to ensure effective enforcement of the sanctions against Libya, but even stronger sanctions are needed to bring about full Libyan compliance. We recognize the problems associated with this position. There is nothing new in the latest allegations of an Iranian link to the bombing of Pan Am 103. We stand by the facts of the November 1991 indictment.

China has consistently abstained from UNSC votes on Libya sanctions.

IRAN ARMS SALES

China is one of Iran's major suppliers of arms and proliferation-related items.

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Conventional Arms: In 1994, China delivered weapons and defense industrial materials to Iran. 11

Obligations: As an adherent to the MTCR Guidelines, a party to the NPT and BWC, and signatory of the CWC, China has international legal responsibilities to restrain proliferation-related exports.

Sanctions Laws: Under current legislation, the USG may not provide certain assistance to any foreign government that provides lethal military equipment to terrorist-list countries, or contributes to Iran's efforts to acquire destabilizing numbers and types of advanced conventional weapons. 1

NARCOTICS

China has become a major transit route for Golden Triangle heroin being shipped to Western markets. The heroin originates primarily in Burma. Heroin addiction is growing in urban areas, especially along transit routes. Illegal opium cultivation occurs in isolated areas primarily along the Burmese border. China is a major source for precursor chemicals used to manufacture heroin and produce amphetamines.

The PRC has a strong domestic drug enforcement effort. China seizes more heroin than any other country in East Asia -- over 4 metric tons (mt) in 1993 and more than 3 mt in 1994. These seizure levels indicate the amount of heroin transiting China is massive. Drug crime and drug use are increasing despite severe penalties. Drug criminals are vigorously prosecuted and harshly punished under a 1990 law which authorizes the death penalty for anyone possessing, selling or transporting more than 50 grams (less than 2 oz.) of heroin.

International drug control cooperation has been lackluster. PRC international drug control efforts have been largely through multilateral forums. China has not been a strong voice in these forums, but does cooperate with the UNDCP.

Bilateral cooperation is limited. Although the Chinese have on several occasions indicated to us they seek drug enforcement cooperation with the US, 1

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ALIEN SMUGGLING

On February 7, the President directed State and Justice to review current efforts and develop new actions to deter trafficking in illegal migrants. He instructed that we expand diplomatic and law enforcement efforts, including cooperation with source and transit countries.

We have had success in curtailing large-scale, ship-based smuggling of Chinese migrants since this problem reached a crisis in 1993. That year, the U.S. identified 11 boats carrying 2,500 illegal migrants; the figure dropped to 5 ships and 450 migrants in 1994.

For their part, the Chinese have cracked down on "snakeheads" in Fujian province, the source of nearly all the migrants interdicted. They have arrested smugglers and corrupt local officials, stopped over 30 vessels and detained several thousand intending illegal immigrants.

Despite these efforts, the problem continues. The U.S. Coast Guard is currently holding the Fang Ming, a converted fishing vessel containing 88 illegal Chinese migrants and 18 crew and enforcers 500 miles southwest of San Diego off the Baja Peninsula. Mexico has agreed to take control of the vessel and repatriate the migrants. The U.S. will reimburse the government of Mexico the cost of the repatriation. All arrangements for the repatriation will be between the Mexicans and the Chinese. It is imperative the Chinese act quickly to make arrangements to accept the returnees, both for the welfare of the migrants and for future deterrent effect. In past cases, Chinese inability to react quickly has produced prolonged delays.

Members of Congress continue to express concern about the treatment of migrants when they return to China. Our missions in China have investigated allegations of mistreatment of returned migrants and have found no incidents of imprisonment or mistreatment. In all previous repatriations, the Chinese have provided assurances the returnees would be treated as victims of the smugglers and not persecuted.

HONG KONG

The 1984 Sino-British Joint Declaration, enshrining the principle of "one country, two systems" and Hong Kong's 1990 Basic Law, providing a blueprint for preserving Hong Kong's "high degree of autonomy" and unique way of life, are the cornerstones for a smooth transition.

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In 1994, after the Legislative Council (Legco) passed Governor Patten's proposed electoral reforms, which included measures such as lowering the voting age and increasing the number of functionally-elected members to be chosen in the 1995 Legco election, China responded by threatening to dismantle all elected bodies in 1997.

Pro-China and business interests fared better than was expected in the 1994 District Board elections. Pro-democracy candidates did well in this year's (March 5) Municipal Council elections. Based on the recent performance of both pro-Beijing and pro-democracy parties, we believe this September's Legco elections will be spirited.

Much must be resolved to ensure a seamless transition. Important issues, including the new airport, the container terminal, post-transitional treaties and agreements, and the nationality issues remain to be resolved before 1997. Although China and the U.K. announced in the end of March that they had reached agreement on the important issue of the new airport corporation, much more needs to be done to ensure Hong Kong's successful transition. U.S. policy encourages both sides to seriously engage to resolve these issues at the negotiating table this year.

The U.S. has substantial interests in Hong Kong and in seeing a successful transition in 1997. Hong Kong is our 14th largest trading partner, with about \$21 billion in two-way trade. U.S. investment exceeds \$10.4 billion. Some 900 resident U.S. firms employ 250,000 people (10% of the work force), and 31,000 American citizens reside in Hong Kong.

Hong Kong residents react with nervous ambivalence to the positive economic situation and uncertain political future. Arrangements made now which clarify how Hong Kong will fare after 1997 will contribute to a sense of confidence about the future. A sudden change in the political or economic climates could trigger an increase in emigration.

Recent indications, such as Sino-British agreement on the new airport authority, confidence-building Chinese statements regarding the reversion, and Sino-British contacts (including the recent visit by Lady Thatcher to Beijing) indicate there may be a softening in tone in the Sino-British relationship.

Our principal concerns include the slow pace of localization of Hong Kong laws, resolution of the nationality issues and resolution of the impasse over Hong Kong's Court of Final Appeal which is to replace the current system of highest legal appeal to the Privy Council in London. Hong Kong both needs the court as a practical matter and needs the confidence of knowing that its courts will remain independent.

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